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TAGS: ENRG PREL ECON EPET PGOV HO
SUBJECT: HONDURAS: CORRUPTION, ELECTRICITY, AND RELATIONS
WITH TAIWAN

Classified By: Classified by Charge James Williard for reasons 1.5 (B,D
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¶1. (C) Summary: Honduras is heading for rolling blackouts within year, according to Leion "Leo" Starkman, outgoing head of national electric company ENEE. GOH officials resist reducing their costs for electricity purchases from as high as USD 0.25 cents per KWh (for thermal generation) to just USD 0.08 (for certain types of renewable generation). GOH opponents claim they will pay no more than USD 0.06 for renewable energy, yet they appear willing to pay up to USD 0.15 for new thermal generation projects. Starkman alleges that this insistence on an unreasonably low tariff for renewable energy is part of a plot by the current big three private thermal electricity generators to block new entrants until an energy crisis is upon Honduras, justifying new and far more expensive "emergency" contracts based on bunker oil. In the meantime, the GOH has ruled out rate increases and is unwilling to exercise leadership in selling the public on restructured contracts (lower prices over longer periods). The GOH has yet to act on a new law to incentivize investment in renewable energy, stalling progress on several viable projects that could be on-line in as little as two years. The GOH continues to champion a Taiwanese-sponsored hydro-electric project, but that project will take six to eight years to complete, and continuing conflicts over price and timeline have twice scuttled scheduled state visits to ink the deal. End Summary.

¶2. (C) The following information was presented by former Minister Leion Starkman to EconChief on October 2. Starkman was recently forced to resign from government under a cloud of accusations of corruption and mismanagement. Starkman is also known to have defaulted on private obligations owed by his import/export company and is accused of other unethical business practices (reported septel). Post finds that many of the facts presented by Starkman correlate with observed events, but assesses that Starkman has inflated his own role in those events with the intent of winning USG favor.

¶3. (C) Leion Starkman Milla (DPOB 17 May 1968, San Pedro Sula, Honduras) served until recently as Minister without portfolio for Investment Promotion and later simultaneously as Director General of the parastatal electric company ENEE. In July a Commission was named to take over the task of

restructuring the failing company. Though nominally still in charge, Starkman was stripped of all authority to sign contracts and make deals. Starkman told EconChief that he was pleased by the formation of the commission, since he understood that any measures taken to fix the ailing parastatal would be unpopular, and he did not want to be personally blamed. Amid a flurry of attacks, Starkman subsequently resigned both his ENEE and Minister positions on September 22. President Zelaya, however, has yet to formally accept those resignations, and Starkman traveled to Roatan on September 30 on GOH business relating to electricity.

¶4. (C) Starkman, told EconChief on October 2 that corruption remains endemic in the company, and that poor electricity service is having a noticeable negative impact on investor sentiment. According to Starkman, within one year the Honduran economy could be facing "nine hour rolling blackouts" if ENEE does not move immediately to install additional generating capacity. (Separately, thermal generation owner Schukry Kafie told EconChief that Honduras has sufficient electricity to last through 2007, but could encounter problems as soon as 2008 or 2009.)

Engineering a Crisis?

¶5. (C) One cause of the coming electricity shortages has been lack of appropriate investment by ENEE, which continues to lose up to 150 million lempiras (nearly USD 8 million) per month. To address this, the new commission is looking at technical and financial changes that can be made at the company. Ordered to reduce payments to private sector generators, the former head of ENEE Juan Bendeck convinced

the firms to reduce fixed costs by extending current contract terms, thus saving an estimated USD 2 million. Unsatisfied, President Zelaya dispatched former Congressman Arturo Corrales, who negotiated a deal for USD 7 million in savings. Still unimpressed, Zelaya ordered Starkman to negotiate once again. Starkman claims to have achieved a savings of USD 20 million, a reduction over current costs of nearly 15 percent. Moreover, he told EconChief, this was done through rescheduling only, such that the net present value of the additional costs is zero. In other words, neither the GOH nor the investors stood to lose money on the deal. This proposal was then approved by the Commission responsible for ENEE, and sent on to the President Zelaya. Zelaya rejected the savings as insufficient. Amidst attacks on the GOH by critics alleging that any extension of the contracts unfairly benefits the private generators, the GOH seems to have lost the will to sign any deal. In the meantime, ENEE continues to lose money daily as expenses outstrip revenues.

¶6. (C) In addition to renegotiating the contract terms, Starkman suggested expediting a proposed agreement with unidentified U.S. or foreign companies to construct a coal-fired electricity generating plant within 12 to 15 months. Given the specter of rolling blackouts, he said, only a coal plant could come on-line within that timeframe, and offer a potential means of diversifying the country,s energy stock. The only near term alternative, to expand or build new thermal plants, would play into the hands of the current thermal generators and increase dependency on volatile world oil prices. Starkman remained adamant that the thermal players would continue to mount opposition to any attempt to diversify away from fuel oil.

Renewables: Talking a Good Game...

¶7. (C) Following the lead of President Jose Manuel "Mel" Zelaya Rosales, the GOH has focused rhetorically on diversifying its energy supplies away from its current near

70 percent reliance on fossil fuels (largely bunker fuel oil and diesel). However, a bill to incentivize investment in renewable energy generation has languished for more than a year. Starkman told Post that, as Minister of Investment Promotion, he drafted a forward-leaning bill based on existing laws in Europe to spur such investments. The bill would set fixed, reasonable costs to be paid for electricity, averaging between USD 0.07 and 0.09 per kilowatt hour depending on the generation technology used. Installations of greater than 40 Megawatts would receive better terms, and all renewable projects would receive a 10 percent premium and preferential tax treatment. Starkman professed frustration that his bill was stuck in the bureaucracy and faces competition from a competing version of the law drafted by the Ministry of Environment SERNA, which is also responsible for energy matters. Starkman says the SERNA bill is not welcoming of investment and would retard rather than spur new projects. (Comment: Starkman's comments are self-serving and likely designed to ingratiate him with the USG. That said, based on Post's unhappy previous dealings with SERNA on renewable energy projects, we find his criticisms of SERNA to be credible. End Comment.)

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...But the Oligarchs Block Them Through Corruption
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¶8. (C) According to Starkman, Of even greater concern is the opposition by certain members of the Commission managing ENEE to any renewable energy project. Starkman claims one commission member (he did not name names) is being paid to defend the interests of the existing thermo-electric generators. To that end, he has blocked any effort to sign contracts for renewable energy at any cost above USD 0.06 per KWh. This cost is below the threshold of most greenfield renewable energy projects, and thus makes most proposals uneconomical. Starkman says the strategy behind this move is to prevent installation of any new project for the next six months. At that point it will be too late to install any

technology but additional bunker or diesel fired thermoelectric plants. The three major thermal generators would thus retain their stranglehold on electricity generation. Showing his true intentions, the commissioner told the commission that USD 0.08 was far too high for renewable energy, but that he would favor paying up to USD 0.15 per KWh for additional thermal generation to meet the coming electricity "crisis."

¶9. (C) This corruption may have held up several projects of which Post is aware: in one instance, a nearly 100 MW wind project remains stalled after over a year of wrangling, largely with SERNA. In another case, Starkman indicated that two sugar mills have proposed adding 30 MW each of bagasse-fired electricity, but again, despite being less expensive than the fossil fueled alternative, the move is being blocked as too costly. Most recently, a U.S. firm has proposed a 120 MW biomass plant that would use a species of grass to produce biodiesel, which it could then use to generate electricity. The biodiesel can be stored to mitigate risks of supply disruption, and can be refined further for use as a transportation fuel (to improve overall project economics). Further, by using the fuel as biodiesel instead of biomass-derived natural gas, the project can use more robust and less expensive generation turbines. The project would be viable at USD 0.075 per KWh, half the cost of fossil fuels and two thirds of the average USD 0.115 per KWh cost being paid by ENEE today. Starkman says he remains supportive of the project, though it is unclear whether he wields any influence at this point. Starkman also all-but drooled over the profits thermo-electric generators earn, and admitted he will enter that business if given an opportunity. Should he do so, Post assesses he would quickly join those forces seeking to stifle competition from renewable sources. Post will continue to support renewable projects, but we note

that special interests continue cynically to attack such plans as too costly.

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Taiwan: Argument Over Dam Derails Two State Visits
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¶10. (C) Starkman then turned to hydroelectricity, championed by Zelaya as the best solution to Honduras' energy needs. Skeptics note that such projects are expensive, unpopular, and take up to a decade to complete, and therefore cannot meet the urgent needs of the country. The biggest proposed project is Patuca III, a 300 MW hydro-electric dam to be designed, built, and operated (DBOT) by the Electric Company of Taiwan. The Taiwanese had originally proposed a two-year period to gear up for construction, a six year construction timeline, and then per KWh costs of USD 0.12 -- a price that sector experts consider to be outrageous for hydro-electric power. Starkman contacted an Italian firm, which presented an offer of one year to start, four years to complete, and USD 0.08 to operate. Starkman then told the Taiwanese they must match those terms.

¶11. (C) Zelaya twice canceled state visits to Taiwan this year, but finally departed for a visit there on October 7. One of the publicly acknowledged goals of the visit is to sign a deal for the Patuca III project. Starkman claims the previously canceled visits were also intended primarily to sign the Patuca III contract, but when the terms could not be agreed to, the visits were scrapped. According to Starkman, when the Taiwanese finally agreed to terms, Starkman discovered they intended to seal the deal by signing an MOU. Starkman objected, requiring instead a full power purchase agreement (PPA) be drafted. He then hired an international consultant to draft the contract, at a cost of USD 40,000 for the estimated six to eight weeks of work. Starkman considered this contract prudent in light of the potential billion dollar deal, but others lambasted the decision as waste, fraud and mismanagement. Though he continues to defend the decision, the uproar over that contract proved to be the final straw, prompting Starkman's September 22 resignation.

¶12. (U) Biographical Information on Leion Starkman

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